

DEPARTMENT OF STATE REVENUE

**LETTER OF FINDINGS NUMBER: 98-0112RST
Sales and Use Tax
For Years 1993 through 1995**

NOTICE: Under Ind. Code § 4-22-7-7, this document is required to be published in the Indiana Register and is effective on its date of publication. It shall remain in effect until the date it is superseded or deleted by the publication of a new document in the Indiana Register. The publication of this document will provide the general public with information about the Department's official position concerning a specific issue.

ISSUES

I. Use Tax – Imposition of Use Tax on Computer Software Updates

Authority: Ind. Code § 6-2.5-3-2;
Indiana Department of Revenue Sales Tax Bulletin #2 (Aug. 1991);
Indiana Department of Revenue Sales Tax Bulletin #8 (Feb. 9, 1990).

The taxpayer protests the imposition of use tax on purchases of computer software updates.

II. Tax Administration – Penalty

Authority: Ind. Code § 6-8.1-10-2.1;
Ind. Admin. Code tit. 45, r. 15-11-2.

The taxpayer protests the imposition of a ten percent (10%) negligence penalty.

STATEMENT OF FACTS

The taxpayer, a banking entity, is a Delaware corporation conducting various types of mortgage services in Indiana. A sales and use tax audit was completed on September 22, 1997. The taxpayer was assessed use tax on several items including purchases of computer software updates from three different vendors. The taxpayer filed a timely protest and on June 20, 2000, the taxpayer waived its right to an administrative hearing.

I. Use Tax – Imposition of Use Tax on Purchases of Computer Software Updates

DISCUSSION

The taxpayer protests the imposition of use tax on purchases of computer software, which the taxpayer characterizes as updates. The purchases were made from three different companies during the audit period. The taxpayer had signed maintenance contracts with the companies supplying the updates. The taxpayer maintains that updates for computer software are not taxable. The taxpayer does not cite any legal sources in support of its position but does submit copies of invoices and contracts for the purchases made.

“An excise tax, known as the use tax, is imposed on the storage, use, or consumption of tangible personal property in Indiana if the property was acquired in a retail transaction, regardless of the location of that transaction or of the retail merchant making that transaction.” Ind. Code § 6-2.5-3-2(a). The taxpayer used tangible personal property in Indiana that was acquired in a retail transaction.

The purchase of pre-written, or canned, computer software is subject to tax.

Pre-written programs, not specifically designed for one purchaser, developed by the seller for sale or lease on the general market in the form of tangible personal property are subject to tax irrespective of the fact that the program may require some modification for a purchaser’s particular computer.

Indiana Department of Revenue Sales Tax Information Bulletin #8 (Feb. 9, 1990).

The copies of invoices and contracts submitted by the taxpayer indicate that the computer software contracted for was pre-written, not custom software designed specifically for the taxpayer. Purchases of updates for pre-written computer software are also taxable. An example from Sales Tax Information Bulletin #2 is illustrative. The example concerns the customer of a computer software company purchasing a maintenance agreement from the software company.

[T]he maintenance agreement also entitles the customer to four program updates per year. The program updates are available to all of the company’s customers who purchased the software package. The maintenance is subject to sales tax because it is a certainty that tangible personal property, the updates, will be given to the customer under the terms of the maintenance agreement.

Indiana Department of Revenue Sales Tax Information Bulletin #2, example 5 (Aug. 1991).

This example clearly shows that computer software updates are taxable as tangible personal property. The invoices submitted by the taxpayer indicate that sales tax was not paid on all of the pre-written software purchases made during the audit period, therefore use tax was properly assessed.

FINDING

The taxpayer's protest is denied.

II. Tax Administration – Penalty

DISCUSSION

The taxpayer protests the imposition of a 10% negligence penalty. The taxpayer states that the penalty was based on the use tax assessed in the audit and the use tax liability resulted from vendors failing to charge sales tax to the taxpayer. The taxpayer also states that it has implemented changes in its procedures to ensure adherence to Indiana tax law in the future.

“If a person incurs, upon examination by the department, a deficiency that is due to negligence, the person is subject to a penalty.” Ind. Code § 6-8.1-10-2.1(a)(3). The penalty is ten percent (10%) of “the amount of the deficiency as finally determined by the department.” Ind. Code § 6-8.1-10-2.1(b)(4). Negligence is defined in the Administrative Code as “the failure to use such reasonable care, caution, or diligence as would be expected of an ordinary reasonable taxpayer. Negligence would result from a taxpayer’s carelessness, thoughtlessness, disregard or inattention to duties placed upon the taxpayer by the Indiana Code or department regulations.” Ind. Admin. Code tit. 45, r. 15-11-2(b).

Provision is made for the waiver of the ten percent (10%) penalty:

The department shall waive the negligence penalty imposed under IC 6-8.1-10-1 if the taxpayer affirmatively establishes that the failure to file a return, pay the full amount of tax due, timely remit tax held in trust, or pay a deficiency was due to reasonable cause and not due to negligence. In order to establish reasonable cause, the taxpayer must demonstrate that it exercised ordinary business care and prudence in carrying out or failing to carry out a duty giving rise to the penalty imposed under this section.

Ind. Admin. Code tit. 45, r. 15-11-2(c).

The taxpayer made many purchases during the audit period where sales tax was not charged and the taxpayer failed to self-assess use tax. This amounts to negligence on the part of the taxpayer and the 10% penalty was properly imposed.

FINDING

The taxpayer's protest is denied.